



NOPOOR POLICY BRIEF



nopoor

Enhancing Knowledge for
Renewed Policies against Poverty

No.27

THE RECOGNITION OF THE IMPORTANCE OF THE INFORMAL SECTOR: EVIDENCE FROM VIETNAM

March 2017

Nguyen Thu Phuong, Pham Minh Thai, Vietnamese Academy of Social Sciences
phuonghn2016@gmail.com, phamminhthai80@gmail.com

Xavier Oudin, Laure Pasquier-Doumer, Institut de recherche pour le développement (France)
oudin@dial.prd.fr, Pasquier@dial.prd.fr>

The household businesses and the informal sector play a key role in the Vietnamese economy and it will do so in the mid-term. It is a major player in the promotion of inclusive economic growth by providing jobs for a large segment of the population, by its flexibility, by the dynamism of one of its segments, and by the large room for improvement of its productivity. Yet, it is up to now largely left out from public policies. By collecting new data on this sector, the NOPOOR project has contributed to raise the attention of the policy makers in order to achieve more productive employment and to tackle the vulnerability of its workers.

INTRODUCTION

There is a broad consensus that Vietnam has made some impressive achievements in recent decades, both in human development and economic performance. Yet, as highlighted in the Human Development Report 2015 (UNDP and VASS, 2016), progress has slowed sharply in the last decade, especially compared to countries with similar levels of development. In particular, Vietnam has recently become less effective at translating economic gains into human development. **Vietnam therefore faces new social and economic policy challenges to achieve more inclusive growth.** Inclusive growth refers to rapid economic growth and a fair distribution of its benefits to provide opportunities for all and leave no one behind. Inclusive growth is part of the Sustainable Development

Goals (SDGs), to which Vietnam has been committed since 2015, particularly Goal 8 to, “*Promote inclusive and sustainable economic growth, employment and decent work for all.*”

Achieving more productive employment and tackling worker vulnerability are important pathways to a new growth model for Vietnam. Household businesses and the informal sector form a cornerstone of this for the following reasons. First, **household businesses are the main job providers after the agriculture sector**. They concentrate almost one-third of all employed workers and more than half of all non-farm employment. One of Vietnam’s key challenges is therefore to improve productivity and working conditions in this sector. Productivity growth needs to be achieved within the sector as structural change via the reallocation of employment to higher productivity sectors appears to be weak, and trends show that this is likely to remain the case for the foreseeable future.

Second, **household businesses and the informal sector form a constituent element of the Vietnamese economy’s resilience**. They act as a buffer, absorbing workers out of agriculture when the enterprise sector is shrinking. The household business sector’s relative economic isolation and flexibility buffer its resilience in the event of economic shocks.

Thirdly, **workers in household businesses and the informal sector in particular are highly vulnerable to sudden shocks and setbacks**. They constitute the ‘new middle’, as defined in the Vietnam Human Development Report 2016, who may have attained only a tenuous level of income security, are often not eligible for social assistance and cannot access social insurance. For these reasons, boosting the productivity of household businesses and the informal sector, and tackling the vulnerability of their workers is critical for broad-based growth, stability, and human development.

Yet, there is no institutional recognition of the household business sector by the state and policies to support this sector are almost inexistent. **By collecting and analysing innovative data on this sector, the NOPOOR project has contributed to raise the attention of policy makers on this sector of activity, to integrate it in the current reflection on the reform of the small and medium enterprise law, and to propose new direction for designing policies towards this sector.**

EVIDENCE AND ANALYSIS

Household businesses are unincorporated businesses owned by individuals or families, which produce or distribute goods and services for the market. The non-farm household business sector features a large proportion of informal household businesses, with no business registration, and a small share of formal household businesses. In Vietnam, these informal household businesses make up the informal sector.

Household businesses and the informal sector are major player in the Vietnamese economy

The household business sector is the main employer after agriculture with nearly one third of total employment and 57 per cent of non-farm employment in 2014. The informal sector makes up more than two-thirds of the household business sector. Besides providing jobs and income to a large share of the working population, **the household business sector is generally the sector the most suited to address the constraints faced by the household business owners**. Household business owners generally work in this sector not because they cannot find a job elsewhere but because the household business sector is the best option compared to the other options open to them. Farmers do not earn enough. Private sector work is no magic bullet because it generally undermines the work-life balance. Public sector work might be preferable to running a household business, but it may be out of reach.

Furthermore, the **household business sector is a major contributor to Vietnamese gross domestic product (GDP), generating almost one-third of non-farm GDP** and 23 percent of total GDP. The informal sector alone accounts for 15 percent of non-farm GDP. In trade, the household business sector’s contribution is very high: 63 percent of value-added generated by the trade sector comes from household businesses.



Household business involved in coal manufacturing ©L. Pasquier-Doumer

The household business sector's weak linkages with other sectors contribute to its economic resilience. Although household businesses and the informal sector can be seen everywhere and are part of everyday life, they are not well embedded in the economy from the point of view of dealings and flows with the formal enterprise sector. Household businesses mainly trade with each other and with final customers. Very few of them engage in subcontracting arrangements with formal enterprises. The relative isolation of household businesses and the informal sector in particular explains why the household business sector is resilient in the event of economic shocks. Fluctuations in the formal enterprise sector have little impact on the informal sector. Yet it is highly dependent on final demand, as it mostly produces and sells to final consumers. The steady growth in individual incomes could be a powerful driver for the sector.

In addition, **the importance of the household businesses and the informal sector should be maintained in the future times.** Employment in the household business sector has not fallen significantly as foreign and domestic enterprise grew. Formalization of the Vietnamese economy has been at work with the reduction of the relative weight of the informal sector in employment, but this process has been tenuous, and it is mostly due to a shift from informal household businesses to formal household businesses.

On the one hand, two structural changes that contribute to the formalization of the economy are at play. First, **youth employment channels less often through the informal sector** than before, as shown by the aging of workers in the informal sector. Second, **self-employed workers, especially in insecure trading activities, are tending to be replaced by household businesses with employees.** On the other hand, the shift from the agricultural sector to the informal sector and the strong complementarity between these two sectors swell the ranks of workers in the informal sector. Working in the informal sector is an agricultural business diversification strategy for a not-inconsiderable proportion of households and this strategy is becoming increasingly widespread. Therefore, **the decrease in the informal sector should be slowed in the coming years by this diversification strategy by households involved in farm activities.**

This sector has the potential to contribute to inclusive growth

The contribution of the household business sector to employment and the creation of wealth makes it an important player in growth. This sector is key to inclusive growth as it provides jobs and incomes to poor and vulnerable people. It delivers goods and services in economic activities not occupied by formal enterprises. It has strong growth potential because it still, on average, has a low level of technology, equipment and skills, and includes a dynamic, innovative segment. Creating a more favourable environment and enhancing skills could boost the sector's productivity and hence increase the national economy's average productivity. The sector's heterogeneity calls for differentiated policies.

The scale of operations in the household business sector is particularly low, especially in the informal sector, leaving room for policy actions. One in two informal businesses employs just one

person. The median value added generated per month by the informal sector is 2.6 million VND. Consequently, around half of informal household business owners make a profit below the minimum wage. **Productivity per worker is also low in the informal sector.** It is just above the level of productivity per worker in the agricultural sector. The upper segment of the household business sector is more efficient, suggesting that there is strong potential for improving productivity in this sector and increasing its contribution to economic growth. The lack of productivity in the informal sector could be explained by a surplus of labour, especially family labour, and by fierce competition in trade and services, which reduces margins and value-added. **The low level of investment by household businesses is another reason for the lack of productivity.**



Household business producing lacquerware ©NOI pictures

However, this does not mean that the household business sector lacks drive. **The average picture paints over the sector's wide range of income, profitability, scale and mode of operation.** By way of an illustration, the average profit of the upper decile of household businesses is 145 times the average profit of the lower decile; 23 percent of household businesses report their profit at less than 3 million VND of capital while 19 percent report more than 50 million; 3 percent of household businesses invest more than half of total investment in the sector. Thus, **a large segment of around one-third of household businesses is dynamic.** These mostly formal household businesses are innovators and in step with the country's modernization. They invest in equipment, operate on a larger scale, are willing to develop their business, and they innovate their product or their production process, or prospect for new customers or change suppliers to reduce their costs.

The need to address worker vulnerability in household businesses and the informal sector

Household business owners and their employees are extremely vulnerable. Household business owners' low incomes rule out their capacity to deal with business shocks and illness by adopting coping strategies free of negative repercussions in the long run. Poor working conditions make employees particularly vulnerable and these conditions have improved very little. Social security is key to policy to tackle this vulnerability, especially in a context where social security for all is a stated policy target for 2025. Health insurance has posted impressive progress in terms of coverage in the household business sector, but obstacles to universal coverage still prevail.

From the household business owner side, shocks and illness are the main source of vulnerability. Almost one-third of household business heads had suffered at least one shock calling for significant expenditure in the previous 24-month period. **Additionally to these shocks, illness is also especially frequent and has long-term impacts on the activity of household businesses.** Around 40 percent of household business heads had experienced illness that affected their work in the previous 12 months. The direct cost of the sickness is particularly high: health expenditures by informal household business owners amount to 41 percent of the profit generated by their, and they often crowd out expenditure on the household business. **Strategies to cope with shock and illness have often long-lasting**

repercussions, such as the strategy used by a not-inconsiderable proportion of informal household businesses to sell productive assets.

Contrary to popular belief, a large share of household business owners cannot count on assistance from friends or family in the event of difficulties, making them even more vulnerable. A full 36 percent of household business owners are highly vulnerable, as their social network does not secure them any risk-sharing or informal insurance mechanisms to cope with shocks: they cannot borrow money for short periods of time, family and friends are unable to provide financial support for their business, and they do not belong to an informal rotating credit and savings association. This belies the commonly held view that solidarity in Vietnam offsets the lack of formal insurance.

On the household business employee side, **a widespread lack of formal arrangements and social protection, frequent non-standard forms of employment, and low earnings place household business employees in a precarious and vulnerable situation**. Only 2 percent of household business employees have a written contract. The proportion of employees with health insurance is slim at 24 percent. Part-time work is frequent and a non-negligible part of employees works with a temporary status. Wage workers' earnings have improved since 2007, but **the earnings gap has widened between wage workers in the household business sector and the formal enterprise sector**. Household business wage workers' earnings are still far behind the formal enterprise sector. They are growing, but at a slower pace than the formal enterprise sector.

POLICY IMPLICATIONS

Most of the household business owners complain of problems running their business and their demand for support is huge. Eight in ten household businesses have problems running their business. The most widespread problem is a lack of market outlets, reflecting the strong competition between household businesses and a lack of information available to them on market opportunities. **This calls for a policy designed to improve the information available to household businesses on market opportunities** in order to develop niches for the sector, especially in trade. The information gathered when setting up a business comes mostly from family members based on the experience of past generations. The fact that there is almost no other source of information, such as formal associations, highlights the urgent need to develop other information channels, particularly those able to convey innovative information. Skills are also an important factor to be developed in order to facilitate market research prior to business start-ups and the creation of innovative products.

While the main problem identified by household businesses is market outlets, **their demand for support is mainly for better access to bank loans**. Almost half of household businesses complain about their financial constraints and ask for help to secure loans. Credit constraint places a strong restriction on the development of household businesses' activities and their capacity to invest and innovate. Formal credit is not suited to household business demand, giving rise to crowding-out effects from informal credit and credit constraint. On the supply side, the lack of very short-term credit gives household businesses considerable cash flow problems, which make them even more vulnerable. In particular, microfinance institutions should do more to target the most credit-constrained informal household businesses. Conversely, the absence of long-term credit for household businesses may be one of the causes of the very low rate of investment, which in turn limits productivity at a low scale. More generally, **the credit constraint is also due to the lack of government institution recognition of household businesses and calls for household business mainstreaming in the government's enterprise policy**. On the demand side, support is needed to improve the creditworthiness information provided by household businesses in order to make formal credit institutions less reluctant to provide them with loans. Training in management and accounting techniques might be effective in this respect, as more than half of all formal household businesses do not keep books.

The vulnerability of household business workers to shocks, in particular to illness, and the inefficiency of informal risk-sharing mechanisms call for improvements to the coverage and quality of the social

security in the household business sector. **Impressive progress has been made with the extension of health insurance coverage in the household business sector**, mostly by developing the voluntary scheme. In 2014, 54 percent of household business owners had a health insurance card, half of them through the voluntary scheme. Progress is much more mixed as far as employees are concerned. Less than one-quarter are covered by health insurance and this figure drops to just 14 percent when family workers are not considered. **Incentives should be created for employers to provide their employees with health insurance**. In addition, the cost of health insurance is beyond the means of the poorest household business owners, especially in the informal sector. **Health insurance coverage could be improved for these household businesses by expanding – or improving the allocation of – social assistance**. More than two-thirds of the poorest quartile of household businesses do not benefit from social assistance, while a not-inconsiderable share of the highest-earning household businesses do. Furthermore, the observed phenomenon of adverse selection places a question mark over the long-term sustainability of the voluntary scheme. The voluntary scheme is subscribed to mostly by less healthy household business owners. Raising the awareness of currently healthy household businesses as to the importance of being covered against health risks and hence encouraging them to contribute to the voluntary scheme would increase the sustainability of the scheme and make funds available for better reimbursement of health expenditures and wider social assistance coverage.

This project has demonstrated that the household business sector plays a key role in the Vietnamese economy and will continue to do so in the medium run. It is a major player in promoting inclusive economic growth by means of jobs for a large segment of the population, the sector's flexibility, the vitality of one of its segments, and the large room for improvement in its productivity. Yet, as in other developing countries, it has to date been largely left out of public policies. Greater sector inclusion in public policy and the development of supportive actions for the sector are necessary conditions to achieve a new growth model for Vietnam with benefits for more of the population.

RESEARCH PARAMETERS

In the framework of the NOPOOR project, an original and innovative data collection to provide new evidence on household businesses and the informal sector. Taking the Household Business and Informal Sector Survey (HB&IS), it applies the methodology of the *1-2-3 surveys*, augmented mixed business/household surveys developed by DIAL researchers (Razafindrakoto and Roubaud, 2003), and conducted in numerous developing countries. This survey conducted in late 2014 and early 2015 is the first national survey ever on this sector in Vietnam with full coverage of its different components. It is representative of the entire country, including urban and rural areas. It is based on a sub-sample of 3411 household business owners drawn from the Labour Force Survey (LFS) of the General Statistics Office (GSO). It contains different modules that provide specific information on the sector's characteristics and the people working in it, its integration into the national economy and how it operates. It builds on the previous IRD-DIAL/GSO-ISS informal sector project (2006-2011), which carried out the first representative survey on the informal sector in Vietnam, restricted to Hanoi and Ho Chi Minh City (Cling *et al.*, 2010). This survey was conducted by the Centre for Analysis and Forecasting (CAF) reporting to the Vietnamese Academy of Social Sciences (VASS) and by research unit DIAL attached to the French National Research Institute for Sustainable Development (IRD) and Paris-Dauphine University. Technical support was provided by the GSO and the Mekong Development Research Institute (MDRI).

FURTHER READINGS

- Cling J.-P., Nguyễn Thị Thu Huyền, Nguyễn Hữu Chí, Phan T. Ngọc Trâm, Razafindrakoto M., Roubaud F. (2010), *The Informal Sector in Vietnam: A focus on Hanoi and Ho Chi Minh City*, Hanoi: The Gioi Publisher.
- DIAL/IRD and CAF/VASS (2017), *Leaving no one behind: the key role of household businesses and informal sector - Lessons from the HB&IS 2014 survey*, Presentation at the Consultation Workshop for HBIS findings, Hanoi, January 2017.
- Pasquier-Doumer L., Oudin X., Nguyen T. (Eds) (2017), *The Importance of Household Business and Informal Sector for Inclusive Growth in Vietnam*. Hanoi: The Gioi Publisher.
- Razafindrakoto M., Roubaud F. (2003), “Two original poverty monitoring tools: the 1-2-3 surveys and the Rural Observatories”, in Cling J.-P., Razafindrakoto M., Roubaud F. (eds), *New International Poverty Reduction Strategies*, Routledge: London/ New York, pp. 313-339.
- UNDP and VASS (2016). *Growth that Works for All: Viet Nam Human Development Report 2015 on Inclusive Growth*. Hanoi: Social Sciences Publishing House.

PROJECT IDENTITY

PROJECT NAME	NOPOOR – Enhancing Knowledge for Renewed Policies against Poverty
COORDINATOR	Institut de Recherche pour le Développement, Paris, France
CONSORTIUM	CDD The Ghana Center for Democratic Development – Accra, Ghana CDE Centre for Development Economics – Delhi, India CNRS (India Unit) Centre de Sciences Humaines – New Delhi, India CRES Consortium pour la Recherche Économique et Sociale – Dakar, Senegal GIGA German Institute of Global and Area Studies – Hamburg, Germany GRADE Grupo de Análisis para el Desarrollo – Lima, Peru IfW Kiel Institute for the World Economy – Kiel, Germany IRD Institut de Recherche pour le Développement – Paris, France ITESM Instituto Tecnológico y de Estudios Superiores de Monterrey – Monterrey, Mexico LISER Luxemburg Institute of Socio-Economic Research – Esch-sur-Alzette, Luxemburg OIKODROM - The Vienna Institute for Urban Sustainability – Vienna, Austria UA-CEE Université d'Antananarivo – Antananarivo, Madagascar UAM Universidad Autónoma de Madrid – Madrid, Spain UCHILE Universidad de Chile – Santiago de Chile, Chile UCT–SALDRU University of Cape Town – Cape Town, South Africa UFRJ Universidade Federal do Rio de Janeiro – Rio de Janeiro, Brazil UNAMUR Université de Namur – Namur, Belgium UOXF-CSAE University of Oxford, Centre for the Study of African Economies – Oxford, United Kingdom VASS Vietnamese Academy of Social Sciences – Hanoi, Vietnam
FUNDING SCHEME	FP7 Framework Programme for Research of the European Union –SSH.2011.4.1-1: Tackling poverty in a development context, Collaborative project/Specific International Cooperation Action. Grant Agreement No. 290752
DURATION	April 2012 – September 2017 (66 months)
BUDGET	EU contribution: 8 000 000 €
WEBSITE	http://www.nopoor.eu/
FOR MORE INFORMATION	Xavier Oudin, Scientific coordinator, IRD-DIAL, Paris, France, oudin@dia.pr.fr Delia Visan, Manager, IRD-DIAL, Paris, France delia.visan@ird.fr Tel: +33 1 53 24 14 66 Contact email address: info@nopoor.eu
EDITORIAL TEAM	Edgar Aragon, Laura Valadez (ITESM) Heidi Dumreicher (OIKODROM) Anne-Sophie Robilliard (IRD), Hélène Lenoble (DIAL)

The views expressed in this paper are those of the authors and do not necessarily represent the views of the European Commission.

